

Analysis of
Business
Trends Plus
Selected
Financial
Indicators

Households Switch Credit Sources . . .

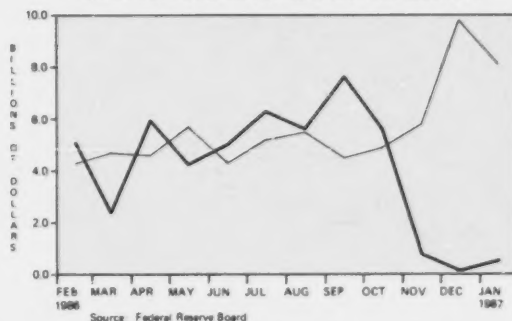
Despite the fact that 1987 is now three months old, one uncertainty which continues to cloud this year's economic outlook is the likely spending behavior of the consumer. For although a robust level of consumer spending has kept the current business expansion rolling along so far, the conventional wisdom states that the combination of subdued employment growth, paltry savings and hefty debt burdens will result in a diminished household contribution to growth from now on. Indeed, some analysts are citing as evidence of this anticipated trend the meager monthly increases in consumer installment debt outstanding since November 1986.

According to this view, with people spending less, they are borrowing less as well. However, while people's willingness to take on new debt may have been indicative of household confidence and spending behavior in the past, in today's tax reform environment it has probably turned into just another misleading economic indicator. The recent flattening of installment debt growth has few implications for the economy's overall health, signifying instead the fact that consumers are beginning to substitute alternative, tax-deductible sources of credit for increasingly non-deductible installment debt, and the likelihood that automobile leasing is fast becoming the preferred form of household auto acquisition.

To be sure, the growth of outstanding installment debt, nearly \$2 of every \$3 of which consists of automobile loans and so-called revolving credit, or credit card balances, slowed abruptly toward the end of last year. Household installment debt totaled nearly \$600 billion at the start of last month. Putting this number in perspective, it represents a sum about 50 percent larger than the widely commented upon foreign debt of all of Latin America. However, consumers acquired an average of only \$500 million more of new debt than they paid off between November 1986 and the end of January 1987. Even more interesting is the fact that it pales by comparison with the nearly \$5½ billion average monthly rise in outstandings during the first ten months of last year.

Credit card debt actually fell by \$400 million in January. This was the largest monthly drop in plastic credit since June 1980, when consumer credit controls were in effect. But signs of an equally sharp drop in household spending are hard to come by, since retail sales advanced briskly in February, while new automobile sales ran at the same annual selling rate during the November 1986-January 1987 period as they did during the same months one year earlier.

REAL ESTATE LOANS (LIGHT LINE) VS.
CONSUMER INSTALLMENT CREDIT (HEAVY LINE)
<DOLLAR CHANGE FROM PREVIOUS MONTH>



. . . In Response To Tax Code Changes . . .

The unusual divergence between spending and installment debt can largely be traced to two developments. First, changes in the Federal tax code which will gradually phase out the deductibility of interest payments for virtually everything but home mortgages and, second, as a corollary, the widespread marketing and popularity of home equity loans. Since mortgage interest payments remain fully tax deductible on principal amounts not exceeding the initial purchase price of the home plus capital improvements, homeownership consumers now have a financial incentive to switch credit sources, borrowing against their palaces to finance either big—(or little—) ticket purchases and/or pay off existing installment debt outstanding.

This seems to be precisely what is going on. As shown in the chart, while consumer credit growth has slowed dramatically, total bank loans secured by real estate, the broad loan group into which home equity lending falls, has soared. In December and January alone, the average monthly increase

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in real estate-backed loans outstanding reached just about \$9 billion, far higher than the preceding 11-month average of less than \$5 billion.

Unfortunately, the available statistics fail to distinguish between new mortgage lending and home equity loans, making it impossible to judge precisely to what extent home equity loans and credit lines are substituting for the more traditional type of consumer credit and, in December at least, what proportion of the increase in real estate lending was for yearend, tax-related purposes. For example, an investor might have

hastened to complete the purchase of an income-producing, rental property in 1986 in order to take advantage of the more generous depreciation schedules contained in the old tax codes. However, despite these caveats, it appears a good bet that the divergence between trends in real estate-backed lending and outstanding consumer credit is more than a mere one- or two-month coincidence, and could persist.

... And Installment Debt Growth Flattens

Nor is the shift to home equity lending the only factor dampening consumer credit growth, thus distorting the meaning of this

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of \$100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Year Ago
Nationwide (3/11/87)	158,112	- 149	- 6,179
New York City (3/18/87)	36,388	- 90	+ 440
Commercial Paper (3/18/87)	339,038	+ 35	+ 37,999

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans			
Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Year Ago
Nationwide (3/11/87)	280,556	- 492	+19,318
New York City (3/18/87)	64,737	- 390	+ 6,341
Total Loans and Leases Gross Adjusted			
	Latest Week	Change Since Week Ago	Year Ago
Nationwide (3/11/87)	783,712	- 2,482	+48,378
New York City (3/18/87)	174,021	+ 934	+10,032

Financial Markets

	Friday 3/27/87	Change Since Week Ago	Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.78%	+ .12	- .75
180-Day Bills†	5.89	+ .13	- .72
Longest Bills†	6.09	+ .17	- .70
Recent Issues:			
63/BS 3/31/89 (When Issued)	6.46	NA	
63/4S 3/31/91 (When Issued)	6.80	NA	
71/4S 11/15/96	7.31	+ .12	
71/2S 11/15/16	7.64	+ .12	
Municipals:			
Bond Buyer-20 Bond Index* (3/26/87)	6.79%	+ .11	- .42
Blue List Total (\$ Million)	\$2,742	+ \$174	+\$1,024
30-Day Visible Supply (\$ Million)	\$3,966	- \$848	+\$ 357
Total	\$6,708	- \$674	+\$1,381
Corporates:			
Moody's Aa Composite (3/26/87)	8.83%	+ .01	- .63
30-Day Visible Supply (\$ Million)	\$2,845	+ \$ 16	-\$2,225
Stocks:			
Dow-Jones Averages:			
Industrials	2,335.80	+ 2.28	+514.08
Transportation	935.44	- 13.45	+107.05
Utilities	217.07	- 3.05	+ 25.54
65 Stocks	872.81	- 4.63	+155.68
N.Y.S.E. Composite Index	168.37	- 1.00	+ 30.68
N.Y.S.E. Avg. Daily Vol. for Week (000's)	170,693	+ 1,203	+14,683
*46% Taxable equivalent 12.57%, † Bond equivalent.			

International Rates

	Friday 3/27/87	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	6.00%	5.88%
1 month	6.38	6.31
3 month	6.38	6.31
6 month	6.38	6.31
1 year	6.50	6.44
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	7.13%	7.13%
Long Term (7 to 15 yrs.)	7.93	7.93
FOREIGN EXCHANGE SPOT RATES		
New York Opening (3/27/87)	Currency Per U.S. \$	Week Ago
Canada	1.3061	1.3106
France	6.0880	6.0980
Germany	1.8238	1.8313
Italy	1298.75	1303.25
Japan	147.85	151.63
Mexico	1107.60	1091.65
Switzerland	1.5200	1.5343
U.K.*	1.6058	1.5978

*U.S. \$ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (3/27/87)	Change Since Week Ago	2/27/85
(Adjusted for Inflation)	+1.2%	-8.4%

former barometer of household sentiment and finances. Another is the increasing popularity of automobile leasing, a trend expected to accelerate under the new tax code. Not only is the deductibility of auto-related interest payments being phased out, but the elimination of the deductibility of state sales taxes has caused a growing number of consumers to switch from auto ownership to auto leasing. In so doing, they avoid the hefty down payment associated with buying most new cars, the tax advantages of which have all but evaporated.

Last year's results are a case in point.

According to the National Vehicle Leasing Association, the number of passenger car leases increased an estimated 20-percent-plus last year, and is likely to increase sharply again this year. But whereas the purchase of an automobile on credit boosts auto-related installment debt outstanding, just as the purchase of a home swells the mortgage debt numbers, the leasing of a vehicle does not, just as renting a house has no effect on mortgage debt totals. This, too, will increasingly distort the meaning of consumer installment debt trends, making reading the consumers' tea leaves that much harder.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 3/25/87	\$ Change Since	
		Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	203.108	— .447	+20.932
Loans to Depository Inst.	.553	+ .051	— .227
Float	.366	— .012	+ .135
Total Reserve Bank Credit	221.091	— .190	+22.215
Treasury Deposits with			
Federal Reserve Banks	2.865	— .390	— .745
Currency in Circulation	207.318	— .386	+14.849
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	168.582	— 1.316	+35.275
Member Bank Reserves:	3/25/87		
Total Reserves Held	55.339	— .098	+ 9.168
Excess (Deficiency)	.868	— .072	— .058
Net Free Reserves	.603	— .146	— .089
Monetary Aggregates †		% Change Since	
		3 Months' Ago*	Year Ago
M1 (3/16/87)	740.2	+ 11.2‡	+ 16.3‡
M2 (February '87)	2,821.3	+ 6.6	+ 9.3
M3 (February '87)	3,519.5	+ 6.9	+ 8.5
Domestic Nonfinancial Debt (4th Q'86)	7,680.6	+ 13.8	+ 12.1

* Seasonally adjusted annual rate.
‡ Four-week moving average.

† Seasonally adjusted.

New York Money Market

Offering Rates 3/27/87	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	5.61%	5.65%	5.72%
* Federal Agencies	5.84	5.85	5.90
* Municipal Notes—High Grade (46% Taxable Equivalent)	7.96	7.87	7.87
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	6.23	6.24	6.30
‡ Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	6.20%	Apr.	6.25%
15- 29 days	6.25	May	6.20
30- 59 days	6.20	Jun.	6.15
60- 89 days	5.80	Jul.	6.12
90-179 days	5.70	Aug.	6.10
180-239 days	5.70	Sep.	6.08
240-270 days	5.70		
‡ Industrial Paper—Prime			
30- 89 days	6.31%	† Federal Funds	
90-120 days	6.25	Effective Rate	6.15%
‡ Discount basis.		* Subject to availability.	† Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'86	\$ 4,259r	\$ 4,241	\$ 4,088
Gross National Product (1982 Dollars)*	4th Q'86	\$ 3,696r	\$ 3,686	\$ 3,622
Percent Change, Annual Rate	4th Q'86	1.1r	2.8	2.1
Change in Consumer Prices*	Feb '87n	4.8% (1)	8.4% (1)	— 3.6%
Change in Producer Prices*	Feb '87	1.2%	7.2%	— 19.2%
Civilian Employment (Thousands of Persons) †	Feb '87	111,382	111,011	108,557
Unemployment as % of Civilian Labor Force †	Feb '87	6.7%	6.7%	7.2%
Personal Income*	Feb '87n	\$ 3,581	\$ 3,549r	\$ 3,435
Leading Indicators Composite Index (1967=100) †	Jan '87	183.8	186.1r	173.4
Industrial Production Index (1977=100) †	Feb '87	127.3	126.8	125.3
Net Change in Consumer Installment Credit †	Jan '87	\$ 0.54	\$ 0.14	\$ 6.32r
U.S. Merchandise Trade Balance	Jan '87	—\$ 14.78	—\$ 12.73	—\$ 14.42
Plant and Equipment Expenditures*	1st Q'87	\$386.82(a)	\$394.34(a)	\$377.94
Private Housing Starts (Thousands of Units)*	Feb '87n	1,851	1,804r	1,923
New Construction Expenditures*	Jan '87	\$ 378.5	\$ 374.9	\$ 373.4
Total Business Inventories †	Jan '87	\$ 592.2	\$ 586.6	\$ 585.0
Total Business Sales †	Jan '87	\$ 428.8r	\$ 448.8	\$ 432.0

* Seasonally adjusted annual rate.

† Seasonally adjusted.

n-Newly reported figure.

r-Revised.

a-Anticipated.

(1) Indicates new series.



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